

STATE BOARD OF ACCOUNTS
302 West Washington Street
Room E418
INDIANAPOLIS, INDIANA 46204-2765

REVIEW REPORT
OF
INDIANA DEPARTMENT OF INSURANCE
STATE OF INDIANA
March 1, 2001 to May 31, 2004

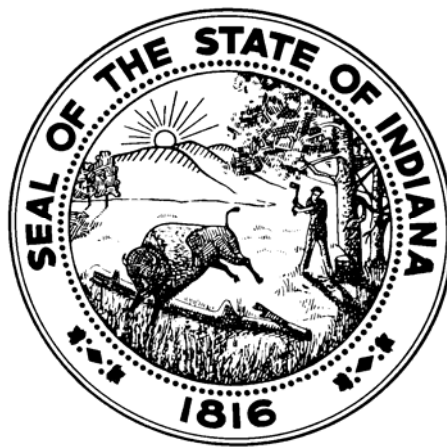


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AGENCY OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Commissioner	Ms. Sally B. McCarty	01-08-01 to 07-15-04
Acting Commissioner	Ms. Amy Strati	07-15-04 to 01-09-05
	Mr. James Atterholt	01-10-05 to 02-28-05



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INDEPENDENT ACCOUNTANT'S REPORT

TO: THE OFFICIALS OF INDIANA DEPARTMENT OF INSURANCE

We have reviewed the receipts, disbursements, and assets of the Indiana Department of Insurance for the period of March 1, 2001, to May 31, 2004. Indiana Department of Insurance's management is responsible for the receipts, disbursements, and assets.

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on the receipts, disbursements, and assets. Accordingly, we do not express such an opinion.

Financial transactions of this office are included in the scope of our audits of the State of Indiana as reflected in the Indiana Comprehensive Annual Financial Reports.

Based on our review, nothing came to our attention that caused us to believe that the receipts, disbursements, and assets of the Indiana Department of Insurance are not in all material respects in conformity with the criteria set forth in the Accounting and Uniform Compliance Guidelines Manual for State Agencies, and applicable laws and regulations except as stated in the review comments.

STATE BOARD OF ACCOUNTS

September 13, 2004

INDIANA DEPARTMENT OF INSURANCE
REVIEW COMMENTS
MAY 31, 2004

SDO ADVANCE

In our prior report (B16740), we noted that the Special Disbursing Officer Fund (SDO) advance of \$1,000 for the Department of Insurance had not been turned over, or reimbursed completely, for several months. During the current review period the SDO advance was not turned over for more than two years.

If a SDO advance is not used within one or two months then the SDO advance is too large and should be reduced. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 7)

INTERNAL CONTROLS OVER CONTRACT PAYMENTS

We observed that the Indiana Department of Insurance does not have a monitoring process in place to determine compliance with the terms of a contract before payment is made. During our testing we found instances where duplicate payments were inadvertently made and subsequently recovered after vendors notified the Department of Insurance of the errors. While we found that total payments to individual vendors are tracked against budget targets they are not tracked against applicable contract terms such as caps on total payments. During our testing we found instances where the total contract cap was not amended in a timely manner to cover anticipated services.

Each agency, department, institution or office is responsible for compliance with applicable contract provisions. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1) The agency should apply control procedures to ensure properly authorized and accurate transactions. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 5)

EFFECTIVE CONTRACT DATES

Our testing found that the Indiana Department of Insurance made payments to vendors for professional services under contracts that were allowed to lapse for significant periods of time. In one instance, a consultant provided services from 1999 through 2004 under a contract which expired in 1998. Contracts to appoint an administrator of the Political Subdivision Risk Management Fund were signed more than 5 months after the effective contract date in 2002 and again in 2004. Other contracts were signed by the vendor, the agency, the Department of Administration, the Budget Agency or the Attorney General's office after the effective date of the contract. Internal controls are weakened when a contract is allowed to lapse or put into effect before proper approval.

Indiana Administrative Code 10 IAC 2-3-1 requires contracts for purchases of professional services of more than \$2,500. Indiana Code 4-13-2-14.1 and 14.2 require that a contract to which a state agency is a party must be properly approved and in writing.

CONTRACT FORMS AND APPROVALS

Our testing identified professional service contracts entered into by the Indiana Department of Insurance (IDOI) without the review or approval by the Department of Administration, the State Budget Agency, or the Attorney General's office. Many of these contracts consist of letters of agreement which lack substantial portions of required State contract language. In one instance, the Department of Insurance appointed an administrator of the Indiana Residual Malpractice Insurance Authority (IRMIA) under a letter of agreement dated July 1, 1975, which contains an automatic renewal clause.

INDIANA DEPARTMENT OF INSURANCE
REVIEW COMMENTS
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(Continued)

Certain types of contracts are entered into routinely by IDOI using standard forms which have not been approved by the Attorney General's office. The IDOI has indicated that its public function would be severely restricted if each such contract was subjected to the standard approval process; however, it has not filed written delegations of authority to approve such contracts with the Department of Administration. These types of contracts include:

1. Appointment agreements to designate the special deputy liquidator for insolvency estates.
2. Reinsurance agreements for insurance companies who participate in the Mine Subsidence Fund.
3. Insurance policies issued by the Political Subdivision Risk Management Fund.
4. Joint custodial agreements for custodial deposits maintained at banks by insurance companies on behalf of policy holders.
5. Claim settlements for the Patient's Compensation Fund, Mine Subsidence Fund and Political Subdivision Risk Management Fund.
6. Consultant contracts for examinations of insurers (as noted in a finding entitled "Consultant Contracts" included in our prior four reports, most recently B10699 and B16740).

Indiana Code 4-13-2-14.3 states that " . . . the attorney general must review for form and legality contracts to which a state agency is a party." Indiana Code 4-13-2-14.1 and 14.2 require that a contract to which a state agency is a party must be properly approved by the Department of Administration, the Budget Agency, and the Attorney General's office. Indiana Code 4-13-2-14.1(b) states that the Department of Administration, the Budget Agency and/or the Attorney General's office may delegate responsibility to approve contracts but that "The delegation must be in writing and must be filed with the Indiana department of administration."

COLLECTION OF EXAMINATION FEES

As stated in our prior four reports (most recently B10699 and B16740), every insurance company that conducts business within the State of Indiana is subject to an examination at least once every three to five years. According to IC 27-1-3.1-9, the Commissioner of the Indiana Department of Insurance (IDOI) is empowered to " . . . retain attorneys, appraisers, independent CPAs or other professionals and specialists as examiners. The cost of retaining these examiners shall be borne by the company that is the subject of the examination." The insurance companies pay the cost of the IDOI examiner's salary plus a 75% loading for fringe benefits and administrative expenses. The examiner's mileage, per diem, the cost of any professionals consulted in connection with the examination and any other expenses are billed directly to the company by the examiner. The examined insurance company may receive as many as four or more invoices for an examination, requiring them to make as many payments.

The existing procedure consists of state employees issuing invoices to, and receiving payments from, the examined insurance companies directly for their travel expenses. Any retained professionals, such as CPA firms or actuaries, invoice IDOI. Invoices are then stamped "approved" and forwarded to the examined insurance company who makes payment directly to the retained firm. To ensure proper internal controls and accountability over public funds, current policy and procedures would dictate that all payments for

INDIANA DEPARTMENT OF INSURANCE
REVIEW COMMENTS
MAY 31, 2004
(Continued)

examinations from the examined companies would be sent to the IDOI, deposited into state accounts, and warrants insured to the employees or retained professionals. The current account structure of the IDOI is not conducive to operation in this fashion.

Each agency is responsible for compliance with applicable statutes, regulations, contract provisions, and state policies. Compliance is required, as applicable, with generally accepted accounting principles, and standards issued by the Governing Accounting Standards Board, Financial Accounting Standards Board, and other standard setting bodies and also with various accounting guides, manuals, and other publications. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

IDOI's official response to this prior finding stated that the examination fees, as statute mandates, are to be borne by the company being examined. The travel expenses are agreed upon by the company and the department prior to the examination. For the department to insert itself between the company and the examiner for the purpose of processing these payments would add an unnecessary bureaucratic layer to a procedure that has functioned successfully.

Upon review of IDOI's official response to our prior reports, in 2001 we requested an Attorney General's opinion regarding direct billings by outside consultants.

In an opinion issued to the State Board of Account's State Examiner on January 16, 2002, and subsequently forwarded to the Commissioner of the Department of Insurance, the Office of the Attorney General stated: "Although it may be expedient to have the company pay individuals directly, the statute does not contemplate such a process." The Attorney General also indicated that, because outside consultants function as agents of the Department, " . . . consultants retained by the department should be compensated by the department even though it is the ultimate responsibility of the companies that are being examined to reimburse the department for those costs."

REIMBURSEMENT OF EXAMINER TRAVEL EXPENSES - STATE EMPLOYEES

As noted in our current finding entitled "Collection of Examination Fees," the Indiana Department of Insurance allows examiners to directly bill insurance companies for reimbursement of their travel costs. Insurance companies forward copies of examiner expense reports to the Department upon payment. During our testing of examiner expense reports, we observed that none of the reports had been signed on the supervisory "Approval" line below the examiner's signature. In addition, we determined that several examiners were billing at rates inconsistent with State travel policies. These examiners were billing combined lodging and meal expenses for in-state travel at a flat daily per diem of \$75. The Department did not obtain copies of receipts to document the expenses itemized on the reports.

We observed that no formal policy existed regarding examiner billing policy during the review period. In addition, we observed that payments made directly to examiners that have been inadequately documented or reviewed raise the appearance of a potential conflict of interest in the performance of their examination duties.

In an opinion issued to the Indiana State Board of Account's State Examiner on January 16, 2002, and subsequently forwarded to the Commissioner of the Department of Insurance, the Office of the Attorney General stated: "although it may be expedient to have the company pay individuals directly, the statute does not contemplate such a process."

INDIANA DEPARTMENT OF INSURANCE
REVIEW COMMENTS
MAY 31, 2004
(Continued)

Financial Management Circular 2003-1, Section 2-6 states "An Agency may develop internal policies and procedures relating to State Travel by State Travelers. Such policies and procedures may not be inconsistent with this Circular and must be approved by both the State Budget Director and the Commissioner [of the Indiana Department of Administration], or their respective designees." Section 3-2 states "Out-of-State Travel must be approved in advance in writing by the Commissioner, and the Agency Head, or their designees . . . In-State Travel must be approved in advance by the Agency." Section 4-7 states "The rates of reimbursement for Travel Allowances shall be those established, in accordance with law, by the State Budget Director and adopted by the Commissioner." 40 IAC 2-1-9(3)(b) states: "A state officer or employee shall not solicit or accept compensation other than that provided for by law for such state officer or employee for the performance of official duties."

IC 27-1-3.1-16 states: "No examiner may be appointed by the commissioner if that examiner, either directly or indirectly, has a conflict of interest."

LACK OF SUBSIDIARY LEDGERS

During our review we observed that the Indiana Department of Insurance (IDOI) did not have effective subsidiary ledgers for the Patient's Compensation Fund, the Mine Subsidence Fund, premium tax revenues or surplus lines tax revenues. The procedures are as follows:

- Patient's Compensation Fund. IDOI administers a medical malpractice fund for which private insurers issue coverage certificates and remit surcharges to IDOI. During the review period, IDOI recorded surcharge payments and corresponding coverage dates in a database. The database did not have the ability to generate summary reports that would allow surcharges recorded to be reconciled to surcharges deposited with the Auditor of State. In 2003 IDOI staff began using a supplementary spreadsheet to track which surcharge payments had been batched together for deposit. This ensures that individual records can be traced through to the corresponding deposit; however a total reconciliation still cannot be performed. In addition, payments are not recorded in the database as paid until any errors in the coverage certificate have been resolved and payment has been received in full. Until partial payments can be recorded toward pending coverage certificates, an effective reconciliation process cannot be performed.
- Mine Subsidence Fund. IDOI acts as a reinsurer for mine subsidence policies issued in certain former coal mining communities. IDOI receives a percentage of all premiums collected in exchange for the promise to honor individual claims. However, IDOI does not collect any detailed information from insurers regarding policies issued and effective dates that would allow it to maintain a subsidiary ledger to verify individual claims against prior premium payments.
- Premium Tax/Surplus Lines Tax Revenues. Spreadsheets are used to reconcile estimated payments received throughout the year to payments reported by companies on tax returns. However, the spreadsheets are not used to generate periodic totals that can be reconciled to deposits with the Auditor of State.

Each agency has the following accounting responsibilities [to] maintain an effective and accurate system for subsidiary and supplementary records. At all times, the agency's manual and computerized records, subsidiary ledgers, control ledger and reconciled bank or Auditor's balance should agree. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

INDIANA DEPARTMENT OF INSURANCE
REVIEW COMMENTS
MAY 31, 2004
(Continued)

VERIFICATION OF CLAIMS - MINE SUBSIDENCE FUND

During the review period from 2002 forward the practice of obtaining an independent engineer's opinion to verify claims against the Mine Subsidence Fund was allowed to lapse. Instead, the Indiana Department of Insurance (IDOI) allowed insurance companies submitting claims for reimbursement to obtain the required engineer's opinion. As noted in our current finding entitled "Lack of Subsidiary Ledgers," during this same time period the IDOI did not independently maintain detailed records regarding policies issued. As a result, IDOI relied on insurance companies not only to attest that a covered incident had occurred, but that the underlying policy had been issued and paid for.

Each agency should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records. Examples of control procedures include: proper authorization of transactions and activities; adequate separation of duties; independent checks on performance; adequate documents and records; and adequate safeguards over access and use of assets and records. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

ACTUARIAL REPORT - PATIENT'S COMPENSATION FUND

The Indiana Department of Insurance administers the Patient's Compensation Fund as created under IC 34-18-6. Annual surcharges from health care providers are deposited into this fund to maintain its solvency. The calculation method to be used for the surcharges is provided for in IC 24-18-5. Through inquiry we found that in 2000, 2001, and 2002, the Department did not retain an actuary to update the surcharge calculation. An updated surcharge calculation was released on August 13, 2003, after the July 1 statutory deadline. On August 15, 2003, surcharges were increased on an emergency basis to protect the solvency of the fund.

IC 34-18-5-2(f)(1) states: " . . . (1) The commissioner shall contract with an actuary that has experience in calculating the actuarial risks posed by physicians. Not later than July 1 of each year, the actuary shall calculate the median of premiums paid for malpractice liability policies . . . (2) After making the calculation described in subdivision (1), the actuary shall establish a uniform surcharge for all physicians practicing in the same specialty class."

SEPARATION OF DUTIES - INSURER EXAMINATION FEES

The Department of Insurance assesses the cost of the periodic examinations it performs of insurance companies to the companies. During our review period, we observed that the same staff person prepares invoices, receipts payments, prepares deposits, posts payments and reconciles deposits to the Auditor of State system for examination fees.

Each agency, department, institution or office should have internal controls in effect, which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

INDIANA DEPARTMENT OF INSURANCE
REVIEW COMMENTS
MAY 31, 2004
(Continued)

BAIL AND RECOVERY AGENT EXAMINATION FEES

During the review period, the Indiana Department of Insurance (IDOI) did not charge the full statutory rate of \$100 for bail bond and recovery agent examination fees. Instead, IDOI negotiated a lower rate of \$68 with an independent testing vendor. Under the terms of the contract with the vendor, the vendor collected examination fees at the negotiated rate directly from applicants as its full compensation under the contract. The difference between the negotiated and statutory rate was not collected from applicants and remitted to IDOI by the vendor, nor was it collected directly by IDOI.

IC 27-10-3-4 states: "... an examination fee of one hundred dollars (\$100) must be submitted to the commissioner with each application for the issuance of a bail agent's license." IC 27-10-3-5 states "... for a license to serve as a recovery agent ... an examination fee of \$100 shall be submitted."

AGENT APPOINTMENT FEES

Prior to its repeal effective January 1, 2002, IC 27-1-15.5-11.1 required each insurer or affiliated group of insurers to file an annual report accompanied by a fee of \$2.50 for each corporate or individual agent on January 1. As noted in our prior reports (B03878, B10699, and B167400), the Indiana Department of Insurance allowed the collection of agent appointment fees to lapse from 1994 through 2000. In late 2001, the Department made a final attempt to collect these fees prior to expiration of the statute. We observed that some fees continued to be collected through 2003. However, the Department did not attempt to inquire or verify whether these fees were owed.

Each agency...is responsible for compliance with applicable statutes. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1) P.L. 132-2001 Section 26 states "The following are repealed [effective January 1, 2002]: IC 27-1-15.5."

INDIANA DEPARTMENT OF INSURANCE
EXIT CONFERENCE

The contents of this report were discussed on January 6, 2005, with Amy Strati, acting Commissioner; and Barb Hayes, Office Operations Manager. The official response has been made a part of this report and may be found on Pages 11 through 13.



STATE OF INDIANA

MITCHELL E. DANIELS, JR., Governor

IDOI

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January 18, 2005

Indiana State Board of Accounts
302 West Washington Street, Room E418
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To Whom It May Concern:

This letter contains the Indiana Department of Insurance's Official Response to the State Board of Accounts Audit Results and Comments as presented to the Indiana Department of Insurance on January 6, 2005.

SDO ADVANCE - The Special Disbursing Officer Fund (SDO) is currently up to date. It will be reduced from \$1000 to \$500. The Department will monitor usage by the new Commissioner and determine if the previous level of \$1000 is more appropriate on a going forward basis.

INTERNAL CONTROLS OVER CONTRACT PAYMENTS and CONTRACT EFFECTIVE DATES - In August 2004, the Department appointed the attorney for the financial services division of the Department to be the contract coordinator. The coordinator has created a database to centralize oversight of all contracts.

CONTRACT FORMS AND APPROVALS - As stated above the Department has centralized the preparing and monitoring of contracts. All contracts are now properly routed through the state agency approval process and all contracts include the boilerplate language required for state contracts. The Auditor has identified certain functions that it asserts should have contracts approved by the Attorney General's office. The Department does not agree that each of the functions is subject to approval of the Attorney General's office. The Department will contact the Office of the Attorney General and review the issues and make changes to our processes as necessary.

COLLECTION OF EXAMINATION FEES - IC 27-1-3.1-9(d) states "when making an examination under this chapter, the commissioner may retain attorneys, appraisers, independent actuaries, independent certified accountants, or other professionals and specialist as examiners. The cost of retaining these examiners shall be borne by the company that is the subject of the examination." (emphasis added). The Department is not violating the statute by its current practice. The Department acknowledges that the Attorney General has expressed an opinion on a preferred practice. However, if the

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NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

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procedure were to change and the Department be responsible for paying consultants and receiving reimbursement from the insurance company the result would be extremely significant to the Department. The issue is more complex than the Department being asked to collect payments from insurance companies and in turn forward to the examiners. Under the suggested interpretation of the IC 27-1-3.1 the Department would be responsible for payment of the examiner's expenses. In the event of a slow payment or default on payment by the insurer the suggested interpretation would result in the Department being financially liable for payment and then the Department would need to seek repayment by the examined entity. Such circumstances could bring a significant lag in payment to the Department for the funds it was required to front to the examiner. A circumstance of slow payment is not unusual, especially with financially troubled companies. Under our current budget the Department is unable to make payments to the examiner until receiving payment from the company. Our budget would need to be increased at a minimum to allow for the possibility of default or delays. As the Department has asserted several times we disagree with this interpretation. Under the Department's interpretation the Department does not believe that it is responsible to the examiner if the insurer fails to pay. The examiner's remedy would be with the company rather than the Department. The Department takes steps to ensure the examiner is aware of this fact and the examiner, in the engagement letter, acknowledges that the Department is not responsible for payment of the expenses. In addition, it is important to note that all examination expenses are reviewed by the Department and approved before being sent to the Company for payment.

Currently outside examiners conduct 95% of the Department's financial and market conduct examinations. We believe that the Department's ability to perform examinations would be severely undercut by the recommended change. The potential consequences are significant, including but not limited to the loss of accreditation with the National Association of Insurance Commissioners. The costs of these examinations and other reviews of financial transactions far exceed the Department's current budget. In light of the State's current financial situation, the Department will not make a change to procedures that are working efficiently and do not clearly violate the statute when the change would have a serious impact on the State's general fund.

However the Department acknowledges that this issue has been raised in the past and needs to be resolved. The Department will review changes to its procedures that will address these issues without exposing the Department to liability to the examiner for expenses that are clearly intended to be paid by the company and not paid, in whole or part, by the State of Indiana. In addition, the Department is reviewing legislation to amend the statute to clearly state acceptable procedures.

REIMBURSEMENT OF EXAMINER TRAVEL EXPENSES – STATE EMPLOYEES -

The Department acknowledges the need for improved procedures and clearer guidance regarding travel expenses for examiners who are state employees. The Department will develop and implement a policy on this issue. Pursuant to IC 27-1-3.1-9 examinations are governed by the NAIC examiners handbook which includes provisions on travel expenses. The Department will not make a decision that could jeopardize its

accreditation status. However, the Department will review the state travel policy and the NAIC handbook in developing a policy for insurance company examinations. The Department will include the submission of receipts in this policy.

LACK OF SUBSIDIARY LEDGERS – The Department has made the following changes on the Patient's Compensation Fund since the audit period. Deposits prepared by the PCF for deposit are verified to the deposit ledger prepared by Office Operations and individual records can be traced to the corresponding deposit. The number of certificates of coverage with issues has been reduced and will be brought to the current basis during 2005. Summary reports have been developed to facilitate the reconciliation process. In regards to premium tax and surplus lines tax revenues the Department can track payment through batches or report of collections. The Department will research procedures whereby tax collections can be reconciled to subsidiary ledgers.

VERIFICATION OF CLAIMS – MNE SUBSIDENCE FUND – The Department acknowledges that for a period of time during the audit period the Department did not have an engineer on contract and reimbursed insurance companies for their incurred costs. In 2004 the Department entered into a contract with an engineering firm thus this issue is resolved. The Department will implement additional procedures to address the issue of verifying insurer's remit the entire amount due to the Mine Subsidence Fund.

ACTUARIAL REPORT – PATIENT'S COMPENSATION FUND - The PCF has retained the services of Milliman USA to provide actuarial assistance to the PCF. Their report on median insurance rates was completed on June 29, 2004. Milliman will continue to provide services in 2005.

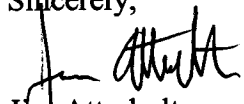
SEPARATION OF DUTIES – INSURER EXAMINATION FEES – The Department will implement procedures to address this issue.

BAIL AND RECOVERY AGENT EXAMINATION FEES – The Department will review the issue and begin charging the statutory fee. The Department will review possible legislation to adjust the fee to the actual cost of the examination.

AGENT APPOINTMENT FEES – The statute in question has been repealed therefore this issue will not arise in the future.

The responses contained herein represent a compilation of responses contributed by the deputies and managers responsible for the subject area of the comment. All responses are true and complete evaluations of the problems noted in the auditor's comments.

Sincerely,


Jim Atterholt
Acting Commissioner